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In The

Supreme Court of the United States

October Term, 1993

IN RE: MOBILE FREEZERS, INC., Debtor

MOBILE FREEZERS, INC.,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

A Chapter 11 Debtor obtained confirmation of its Plan of Reorganization which provided, *inter alia*, that unsecured creditors were to receive a percentage of their claims in full satisfaction of those claims and that the Reorganized Debtor was to retain all property of the Chapter 11 estate. After the order of confirmation became final, the Reorganized Debtor received an offer to purchase substantially all of its assets used in one of its business operations for an amount that exceeded the amount required to be distributed to unsecured creditors under the confirmed Chapter 11 Plan. The Reorganized Debtor had no knowledge of the purchaser's willingness to buy the assets at the time of the entry of the order confirming its Plan. The Reorganized Debtor completed the sale, with the Bankruptcy Court's authorization, resulting in the Reorganized Debtor receiving an amount sufficient to pay the entire distribution to unsecured creditors required under the confirmed Plan plus retain approximately $237,000 for its other operations.

1. Does the binding effect of the provisions of the confirmed Plan, 11 U.S.C. § 1141, prohibit a court, by virtue of the doctrine of *res judicata, Stoll v. Gottlieb*, 305 U.S. 165, 59 S. Ct. 134, 83 L. Ed. 104 (1938); *In Re Pavlovich*, 952 F.2d 114 (5th Cir. 1992), from converting the case to a Chapter 7 proceeding in order to alter the confirmed Plan's provisions and transfer the postconfirmation windfall away from the Reorganized Debtor and to the unsecured creditors?

2. Does a court exercising bankruptcy jurisdiction possess the equitable power to convert a Chapter 11 with a confirmed Plan to a Chapter 7 in order to produce a result that is contrary to the provisions of the confirmed Plan in light of 11 U.S.C. § 1141 which provides that the terms of the confirmed Plan are binding on all parties, the holding in *Stoll v. Gottlieb, supra*, that the Plan

provisions are entitled to *res judicata* effect, the declaration of 11 U.S.C. § 1144 that the exclusive basis for revoking a Chapter 11 Plan confirmation order is fraud in its procurement, and the holding in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S. Ct. 963, 969, 99 L. Ed. 2d 169 (1988) that the equitable powers of the Bankruptcy Court "must and can only be exercised within the confines of the Bankruptcy Code"?

3. Does a postconfirmation sale by a Reorganized Debtor of substantially all of its operating assets with the Bankruptcy Court's approval constitute a "material default" within the meaning of 11 U.S.C. § 1112(b) and require conversion to Chapter 7 as a matter of law if the confirmed Plan does not specify how long the Reorganized Debtor will retain those assets and the Reorganized Debtor makes provision for payment in full to unsecured creditors of their required distribution pursuant to the Plan out of the sales proceeds?

4. Upon conversion of a Chapter 11 proceeding in which a reorganization plan has been confirmed to a Chapter 7 proceeding, are the assets of the Reorganized Debtor acquired post confirmation included in the converted Chapter 7 estate?

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PETITION FOR A WRIT OF CERTIORARI

Petitioner, Mobile Freezers, Inc., the Reorganized Debtor, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit.

OPINIONS BELOW

The United States Bankruptcy Court for the Southern District of Alabama denied the motion of the United States Defense Logistics Agency to Convert the Chapter 11 proceeding filed by the Petitioner, Mobile Freezers, Inc., to a Chapter 7 proceeding and authorized the disbursement, after payment of all required distributions under its confirmed Plan, of certain sales proceeds to the Reorganized Debtor. *See In re Mobile Freezers, Inc.* Order dated July 2, 1991 (U.S. Bankruptcy Court for the Southern District of Alabama, Case No. 90-00232) App. C at 18a-26a. The United States District Court for the Southern District of Alabama reversed the decision of the Bankruptcy Court, converted the Chapter 11 case to a Chapter 7 proceeding, and ordered the sales proceeds distributed in accordance with Chapter 7 of the Bankruptcy Code. *See In Re Mobile Freezers, Inc.*, 146 B.R. 1000 (S.D. Ala. 1992); App. B at 3a-17a. The United States Court of Appeals for the Eleventh Circuit affirmed the decision of the United States District Court finding that the District Court's conclusion was justified by equitable considerations and the existence of one or more material defaults by Mobile Freezers, Inc. *In Re Mobile Freezers, Inc.* (*Mobile Freezers, Inc. v. United States of America*, 11th Cir. Case No. 92-7033) (unpublished opinion); App. A at 1a-2a.

STATEMENT OF JURISDICTION

This petition arises out of an order entered by the United States Bankruptcy Court for the Southern District of Alabama denying a motion filed by the United States Defense Logistics Agency, a creditor in Mobile Freezers' Chapter 11 proceeding to convert that proceeding to a Chapter 7 after confirmation of Mobile Freezers' Chapter 11 Reorganization Plan. The United States Bankruptcy Court had jurisdiction pursuant to 28 U.S.C. § 157. A timely appeal was filed by the creditor to the United States District Court for the Southern District of Alabama which court

had jurisdiction of the appeal under the provisions of 28 U.S.C. § 158(a). An appeal was timely filed by the Reorganized Debtor to the United States Court of Appeals for the Eleventh Circuit which had jurisdiction pursuant to 28 U.S.C. § 158(d). A panel of the Eleventh Circuit Court of Appeals entered its judgment on January 20, 1994. No application for rehearing was filed. This petition for writ of certiorari is authorized by 28 U.S.C. § 1254(1).

STATUTES INVOLVED

11 U.S.C. § 1141 provides, in pertinent part:

> (a) Except as provided in subsections (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.
>
> (b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.
>
> (c) Except . . . as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.

> (d) (1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan —
>
> > (A) discharges the debtor from any debt that arose before the date of such confirmation . . . ."

11 U.S.C. § 1112 provides, in pertinent part:

* * *

> (b) Except as provided in subsection (c) of this section, on request of a part in interest . . . and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter whichever is in the best interest of creditors and the estate, for cause, including —
>
> * * *
>
> > (7) inability to effectuate substantial consummation of a confirmed plan; [or]
> >
> > (8) material default by the debtor with respect to a confirmed plan; . . . .

11 U.S.C. § 1144 provides, in pertinent part:

> On request of a party in interest at any time before 180 days after the date of the entry of the order of confirmation, and after notice and a

> hearing, the court may revoke such order if and only if such order was procured by fraud. An order under this section revoking an order of confirmation shall —
>
> (1) contain such provisions as are necessary to protect any entity acquiring rights in good faith reliance on the order of confirmation; and
>
> (2) revoke the discharge of the debtor.

STATEMENT OF THE CASE

A. Course of Proceedings Below

On July 12, 1991, the Bankruptcy Court entered its order confirming Petitioner's Chapter 11 Plan. App. C at 19a. On February 19, 1992, Debtor filed a motion with the Bankruptcy Court for authority to sell substantially all of the assets used in the processing operation of its business. That sale was approved by the Bankruptcy Court. App. C at 20a. In response, the United States Defense Logistics Agency filed a motion to dismiss or convert the case to a Chapter 7 proceeding. App. C at 18a. No motion to revoke confirmation pursuant to 11 U.S.C. § 1144 was filed and no allegation of fraud in the procurement of the order of confirmation of the Plan was made.

On July 2, 1992 the Bankruptcy Court entered its findings of fact, conclusions of law, and order authorizing the Reorganized Debtor to immediately pay all distributions due under the Plan out of the proceeds from the sale and to retain for Reorganized Debtor's future business operations any excess. App. C at 24a and 26a. The Bankruptcy Court further denied the motion to dismiss or convert filed by the United States Defense Logistics Agency. App. C at 23a and 25a.

The Defense Logistics Agency appealed the Bankruptcy Court decision to the United States District Court for the Southern District of Alabama. On October 20, 1992, the Honorable Virgil Pittman reversed the Bankruptcy Court, remanded the matter to the Bankruptcy Court for entry of an order converting the case to a Chapter 7, and directed that the proceeds from the sale be paid "as provided by Chapter 7 and consistent with [this] order." 146 B.R. 1000 (S.D. Ala., 1992). App. B at 17a. Judge Pittman held that the bankruptcy judge had abused his discretion in failing to convert the case to a Chapter 7. App. B at 3a.

The Reorganized Debtor appealed the District Court's order to the Eleventh Circuit Court of Appeals. The District Court stayed its order of conversion pending appeal.

A panel of the Eleventh Circuit affirmed the District Court in an unpublished single paragraph per curiam opinion holding:

> . . . there were one or more material defaults by the Debtor, and . . . the record contains overwhelming evidence of equitable considerations pointing to the result reached by the district court.

App. A at 2a.

B. Statement of the Facts

Mobile Freezers, Inc., Petitioner, filed a Chapter 11 proceeding in the United States Bankruptcy Court for the Southern District of Alabama. App. C at 19a. At the time of the filing of its Chapter 11, Mobile Freezers was engaged in the business of processing, freezing, and packaging fresh shrimp. App. C at 19a. Prior to filing its Chapter 11, Mobile Freezers, Inc. had, in addition to the processing business, engaged in the business of providing

seafood unloading services, buying shrimp at shipside, and selling it at wholesale. App. C at 22a.

After several months in the Chapter 11 proceeding, Mobile Freezers filed a Chapter 11 Plan and subsequently a Disclosure Statement. Both were amended in the course of the bankruptcy proceeding. The Amended Plan that was eventually confirmed provided that administrative claims, priority claims, and secured claims were to be paid 100% of their allowed amounts and that unsecured claims were to be paid 20% of their allowed amounts in monthly installments over a period of years. App. C at 19a-20a. The Amended Plan further stated that Mobile Freezers, Inc. as the Reorganized Debtor, would retain all of its property and would extend its sublease on its facility.

Mobile Freezers, Inc.'s Plan was confirmed on July 2, 1991 by an order that discharged all Mobile Freezers, Inc. indebtednesses except as provided in the Plan, and that revested title of all of the Debtor-in-Possession's assets in Mobile Freezers, Inc., as the Reorganized Debtor, subject, however, to the terms of the Plan. App. C at 19a and 24a. The Plan was confirmed over the objections of a number of creditors who actively opposed confirmation. App. C at 19a. The Reorganized Debtor operated its shrimp processing business from its then current location for eight months after the Bankruptcy Court's order confirming the Plan. Inferred from App. C at 19a and 20a.

After the order confirming the Plan became final, the Reorganized Debtor received an offer from its landlord to purchase its processing equipment, the sublease, and certain other intangible property as a going concern for $775,000, App. C at 20a, an amount exceeding the liquidation value stated in the Disclosure Statement filed by Mobile Freezers prior to confirmation of its Chapter 11 Plan. App. C at 22a. No creditor or other party in interest asserted or proved that the liquidation values stated in the Disclosure

Statement were not truthful or that Mobile Freezers or any of its agents, officers, or directors, had any knowledge of its landlord's interest in the purchase prior to the entry of the order of confirmation in July, 1991. App. C at 22a.

The Debtor sought and obtained Bankruptcy Court approval for the sale to the landlord, App. C at 20a, pursuant to 11 U.S.C. § 1142. Out of the proceeds of the sale, the Debtor, with Bankruptcy Court approval, paid in full all priority and administrative claims, App. C at 21a, in accordance with the confirmed Plan. The balance of the sales proceeds have been held in a special account pending court disposition of the same. App. C at 21a.

The Bankruptcy Court determined that from the $535,262.61 balance available after payment of the administrative and priority claims, $298,198.61 was required to pay the remaining creditors their respective distributions under the Plan. App. C at 21a. The remaining $237,064 less the federal and state income taxes incurred as a result of the sale was determined to be property of the Reorganized Debtor. App. C at 26a.

The order approving the disbursements to the unsecured creditors and to the Reorganized Debtor was initially stayed by the Bankruptcy Court and subsequently by the District Court. The funds remain on deposit in a special account maintained by the Reorganized Debtor.

REASONS FOR GRANTING THE WRIT

SUMMARY OF ARGUMENT

Consistent and predictable treatment of a Reorganized Debtor, its assets, and its postconfirmation creditors by courts after confirmation of its Chapter 11 Plan is important to the goal of rehabilitation underlying in Chapter 11 of the Bankruptcy Code. Members of the business community will not transact business with a Reorganized Debtor if they cannot rely on the prior orders of the Bankruptcy Court as establishing conclusively the rights of prebankrupty creditors against the Reorganized Debtor and the rights of the Reorganized Debtor to manage its own affairs. Without normalized business relationships after confirmation of its Chapter 11 Plan, the Reorganized Debtor cannot successfully carry out the terms of its Reorganization Plan and become a viable productive business.

In the case at bar, the United States District Court ordered the conversion of a postconfirmation Chapter 11 proceeding to a Chapter 7 proceeding for the purpose of increasing the amount of the distributions paid to prepetition unsecured creditors above the amounts to which they were entitled by a previously entered binding order confirming the Debtor's Chapter 11 Plan. By affirming that decision the Eleventh Circuit Court of Appeals has sanctioned a judicial attack on the sanctity and conclusiveness of a prior final order of confirmation. This decision has raised serious concern as to whether the orders of confirmation entered by bankruptcy courts are such that they can be relied upon by the parties and others to conduct future transactions with Reorganized Debtors. The decision in this case is a departure from the accepted and usual course of judicial proceedings which recognize the conclusiveness of an order of confirmation entered by a bankruptcy court. *Stoll v. Gottlieb*, 305 U.S. 165, 59 S. Ct. 134, 83 L. Ed. 104 (1938); 11 U.S.C. § 1141. It is one which may jeopardize the future rehabilitation efforts of all Reorganized Debtors.

The Eleventh Circuit's decision that the District Court, sitting as an appellate court, properly reversed the Bankruptcy Court's discretionary refusal to convert a Chapter 11 to a Chapter 7 because the District Court concluded conversion, postconfirmation, would increase the distribution to unsecured creditors over the amount those creditors would receive under the confirmed Plan presents important questions of federal bankruptcy law which have not been, but should be, settled by this Court in order to provide guidance and stability to Chapter 11 Reorganized Debtors and to the business community transacting business with those Reorganized Debtors after confirmation, namely:

a. Is it permissible for a court to exercise its equitable powers to convert a Chapter 11 in which a Plan has been confirmed to a Chapter 7 because that Court deems it more equitable to give a postconfirmation windfall to prepetition creditors of the Reorganized Debtor if those equitable powers are exercised in disregard of the provisions of 11 U.S.C. § 1141 which hold that the order of confirmation binds the creditor and the Debtor to the Plan's terms and discharges all preconfirmation debts except as provided for in the Plan, the provisions of 11 U.S.C. § 1144 which expressly forbid the revocation of an order of confirmation except for fraud in its procurement, and the teaching of *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S. Ct. 963, 969, 99 L. Ed. 2d 169 (1988) which holds that a Bankruptcy Court can only exercise its equitable powers within the confines of the Bankruptcy Code; and

b. Does property received after confirmation of a Chapter 11 Plan by a Reorganized Debtor become property of a subsequently-created Chapter 7 estate when the Chapter 11 is converted to a Chapter 7 after Plan confirmation?

The Eleventh Circuit's affirmance of the District Court's determination, as a matter of law, that the sale, after confirmation, by the Reorganized Debtor of substantially all of its assets used in one operation of its business constituted a "material default" within the meaning of 11 U.S.C. § 1112(b)(8), mandating conversion of the case to a Chapter 7 proceeding, presents an important question of federal bankruptcy law regarding the rights of a Reorganized Debtor to validly sell and transfer its property after confirmation of its Plan which question has not been, but should be, settled by this Court.

ARGUMENT

INTRODUCTION

This case involves the rights and obligations of a Reorganized Debtor following entry of an order of confirmation of its Reorganization Plan to conduct business with third parties and to use and control its assets free of the interference of its prepetition creditors. Few reported cases give Reorganized Debtors, their managers, or the creditor and customer population with whom those Reorganized Debtors conduct business guidance as to the powers of the Reorganized Debtor after confirmation and/or the financial risks faced by those who transact business with the Reorganized Debtor following entry of an order confirming a Chapter 11 Plan. As demonstrated by the events and result in this case, such guidance is needed.

In the case at bar, an opportunity, unanticipated at the time of the entry of the order of confirmation, was presented to the Reorganized Debtor's management after entry of the order of confirmation. That opportunity — an offer by the Reorganized Debtor's landlord to purchase the Reorganized Debtor's shrimp processing business for an amount in excess of the amount required to pay the Reorganized Debtor's creditors the full amount of their distriubtions under the confirmed Chapter 11 Plan — led to

the conversion of the Reorganized Debtor's Chapter 11 proceeding to a Chapter 7 proceeding and an order requiring that all assets, including those acquired post confirmation, be used to increase the dividend paid to prepetition Chapter 11 creditors. The appellate courts, in reaching their decisions, ignored the impact of the conversion order on postconfirmation unpaid creditors who had dealt with the Reorganized Debtor in good faith, ignored the concerns of employees of the other business operation of the Debtor who were affected by the conversion and ignored the plain language of 11 U.S.C. § 1141.

If the decisions of the District Court and the Court of Appeals in this case are valid, managers of Reorganized Debtors will avoid transactions which undoubtedly benefit the Reorganized Debtor and its creditors because of fear that receipt of too much profit or revenues will lead to Chapter 7 liquidation of their businesses. Purchasers of assets, other than in the ordinary course of business, from a Reorganized Debtor will have caused to doubt the Reorganized Debtor's authority to consummate the sale if this decision, allowing a collateral attack on this conclusiveness of the order of confirmation, is allowed to remain. Equally as important, potential post–confirmation lenders, vendors, and suppliers will avoid doing business with the Reorganized Debtor for fear they will be dragged into a bankruptcy proceeding which they and the Reorganized Debtor believed had been concluded and in which their claims for payment have been relegated to the status of prepetition unsecured claims. *In re Pauling Auto Supply, Inc.*, 158 B.R. 789 (Bkrtcy. N.D. Iowa 1993). Because of the number of Reorganized Debtors currently operating with confirmed Chapter 11 Plans and because of the need by both the creditor and the Reorganized Debtor management community to better understand the risks involved in doing business with or conducting the business of Reorganized Debtors, the issues presented by this petition are significant and important to commercial transactions within the United States. Resolution of these issues is vital to the

successful achievement of the reorganization goal of Chapter 11 of the Bankruptcy Code.

ISSUE I.

11 U.S.C. § 1141 clearly and unequivocally expresses Congress' intent to make the entry of an order of confirmation the event triggering a new beginning for the Debtor. Upon entry of the order of confirmation all of the property of the financially distressed Debtor vests in the Reorganized Debtor, subject to the terms of the Plan, 11 U.S.C. § 1141(b), all of the debts owed by the Debtor or Debtor in Possession prior to entry of the order of confirmation are discharged, subject to the terms of the confirmed plan, 11 U.S.C. § 1141(d), and all parties in interest, including the prebankruptcy creditors become bound by the terms of the Plan. 11 U.S.C. § 1141(a). *United States v. Redmond,* 36 B.R. 932 (D.C. Kansas 1984); *In re Pauling Auto Supply, Inc., supra.* The former Chapter 11 estate ceases to exist, *In re Pauling Auto Supply, Inc., supra; In re T.S.P. Industries, Inc.,* 117 B.R. 375 (Bkrtcy. N.D Ill. 1990) and a new Reorganized Debtor is created owning all of the property previously owned by the Debtor in Possession, but subject to the debts and terms stated in the confirmed Chapter 11 plan.

The new Reorganized Debtor is free to conduct its business without the restraint of court supervision over its affairs (11 U.S.C. §§ 363, 364, 365, 328) and without its protection (§ 362[d]). The Reorganized Debtor, however, does not sever all ties with the Bankruptcy Court. It remains subject to the Bankruptcy Court's jurisdiction in the event the order of confirmation was procured by fraud, 11 U.S.C. § 1144 it materially defaults under its Plan or is unable to substantially consummate its Plan, 11 U.S.C. § 1112(b), it needs the court's assistance in carrying out the terms of its Plan, 11 U.S.C. § 1142, or it seeks to modify its Plan, 11 U.S.C. §1127. Absent the occurrence of one of these events, the Reorganized

Debtor is free to conduct its business in any lawful manner it sees fit so long as it does so consistent with the terms of its confirmed Plan and the order confirming that Plan.

When the Bankruptcy Court entered its order confirming Mobile Freezer Inc.'s Chapter 11 Plan of Reorganization, all matters covered by the Plan of Reorganization were conclusively determined and became subject to the doctrine of *res judicata. Stoll v. Gottlieb,* 305 U.S. 165, 59 S. Ct. 134, 83 L. Ed. 104 (1938); *Republic Supply Co. v. Shoaf,* 815 F.2d 1046 (5th Cir. 1987); *In re Pavlovich,* 952 F.2d 114 (5th Cir. 1992). The amount of the distribution to be paid by the Reorganized Debtor to unsecured creditors and the Reorganized Debtor's ownership of the property previously owned by the Debtor in Possession were two specific terms of the Plan confirmed by that order. Prepetition creditors were barred by the doctrine of *res judicata* and the provisions of 11 U.S.C. § 1141 from changing those terms after confirmation due to the receipt by the Reorganized Debtor of a subsequent windfall. The United States District Court's decision affirmed by the Eleventh Circuit Court of Appeals, to convert the Chapter 11 to a Chapter 7 for the purposes of undermining the terms of the confirmed Plan violates both the doctrine of *res judicata* and the provisions of 11 U.S.C. § 1141.

ISSUE II.

As a result of the confirmation order, the prepetition balances owed to the prepetition unsecured creditors in excess of 20% were legally discharged. Because of the *res judicata* effect of the order of confirmation, the only permissible method available to creditors for changing the amounts owed to those creditors was invalidation of the order by revoking the Reorganized Debtor's discharge pursuant to 11 U.S.C. § 1144. *In re Longardner & Associates, Inc.* 855 F.2d 455 (7th Cir. 1988), *cert. denied,* 489 U.S. 1015, 109 S. Ct. 1130, 103 L. Ed. 2d 191 (1989); *In re Newport Harbor*

Associates, 589 F.2d 20 (1st Cir. 1978). Otherwise, the *res judicata* effect of the order of confirmation precluded those creditors from forcing the Reorganized Debtor to pay them more than twenty percent (20%) of their prepetition debts. 11 U.S.C. § 1144 allows revocation "if and only if the order was procured by fraud." *In re Longardner & Associates, Inc., supra.* The creditor did not file such a motion and did not allege or prove fraud in the procurement of the order of confirmation. As of the date of the filing of the motion to convert, the Reorganized Debtor did not owe the creditors more than 20% of their claims.

Yet, the opinion of the District Court in this matter makes clear that its primary reason for conversion was to transfer the benefit of the postconfirmation windfall to the unsecured creditors so that they could receive more than the 20% provided for in the confirmed Plan. The Eleventh Circuit Court of Appeals affirmed the District Court's action, holding that equitable considerations supported the District Court's result. However, that result is contrary to the provisions of the Bankruptcy Code. Neither the District Court nor the Eleventh Circuit had the right to exercise their equitable powers in a bankruptcy case in a manner inconsistent with the provisions of the Bankruptcy Code. *Norwest Bank Worthington v. Ahlers,* 485 U.S. 197, 206, 108 S. Ct. 963, 969, 99 L. Ed. 2d 169 (1988).

Requiring the conversion to a Chapter 7 of a Reorganized Debtor in order to facilitate the payment of a dividend in excess of the amount provided for in a confirmed Chapter 11 Plan is inconsistent with 11 U.S.C. § 1141 defining the binding effect of the confirmation order and 11 U.S.C. § 1144 defining the exclusive method for revoking that final order. Pursuant to *Norwest Bank Worthington v. Ahlers, supra,* the District Court's exercise of its equitable powers in such a fashion is not permissible. The Eleventh Circuit's opinion affirming the District Court's decision sanctions a result which is inconsistent with both statutory mandate and judicial precedent.

ISSUE III.

11 U.S.C. § 1112(b) describes, as an example of "cause" justifying conversion of a postconfirmation Chapter 11 case, "material default by the debtor with respect to a confirmed plan." The Bankruptcy Court found that the Reorganized Debtor had defaulted in the performance of its confirmed Plan, but held that the default was not material within the meaning of 11 U.S.C. § 1112(b)(8), App. C at 23a. The Bankruptcy Court refused to exercise its discretion under 11 U.S.C. § 1112(b) to convert because of the default. App. C at 25a. The District Court reversed the Bankruptcy Court, holding that the Debtor's sale of its shrimp processing assets and its failure to collect a $6,000 equity infusion from its stockholders were "material" defaults. App. B at 10a-11a. The Eleventh Circuit affirmed, stating that its review of the record caused it to conclude that sufficient evidence of one or more material defaults were presented. App. A at 2a.

The basis for the District Court's conclusion that a material default had occurred is its determination that the "asset sale clearly contradicts the terms of the Plan and is therefore a material breach". App. B at 10a. The District Court's conclusion on this matter is in conflict with the rights accorded a Reorganized Debtor after confirmation, pursuant to 11 U.S.C. § 1141. Since 11 U.S.C. § 1141 revested title of the Debtor in Possession's assets in the Reorganized Debtor and since the confirmed Plan did not require the Debtor to retain its assets for any specified period of time, the Reorganized Debtor had the right to sell, after confirmation of its Plan, all or any part of its assets, provided it did not use the proceeds in a manner inconsistent with its obligations under the confirmed Chapter 11 Plan and did not jeopardize the creditors' rights to receive their distributions under that Plan. 11 U.S.C. § 1141. The District Court's conclusion that a material default occurred when the Reorganized Debtor sold the assets is premised upon its failure to recognize that confirmation of the Chapter 11

Plan terminated the bankruptcy proceeding's restraint on the former Chapter 11 Debtor's affairs.

The remaining two defaults, *i.e.*, the Debtor's failure to collect $6,000 from the shareholders and its failure to pay two monthly installments to unsecured creditors, occurring at a time when the Debtor was prepared to immediately pay the full distribution owed to creditors under the confirmed Plan cannot be characterized as a matter of law, as the kind of defaults under the Plan as constituted "material" defaults, within the meaning of 11 U.S.C. § 1112(b)(8), *i.e.*, defaults so substantial and important that their occurrence defeated the essential purpose of the confirmed plan. 6 *Williston on Contracts* (3rd Ed.) Section 866. The District Court's determination that the Bankruptcy Court abused its discretion in refusing to convert this confirmed Chapter 11 case because of those defaults was in error.

The absence of judicial precedent on the issue of what conduct constitutes a "material" default in the performance of a Chapter 11 Plan, as a matter of law, sufficient to require conversion to Chapter 7 should be ended so that the lower courts cannot use that lack of precedent to justify an interpretation designed to produce a result that is contrary to specific provisions of the Bankruptcy Code.

ISSUE IV.

The District Court's order not only reversed the Bankruptcy Court's refusal to convert, but also directed that the sales proceeds be distributed in accordance with Chapter 7 of the Bankruptcy Code. The District Court judge apparently assumed that the proceeds of the sale would be property of the converted Chapter 7 estate. The Eleventh Circuit Court of Appeals did not address this issue.

Property acquired by a Reorganized Debtor after confirmation

of its Plan is not property of the converted Chapter 7 estate. *In re T.S.P. Industries, Inc.*, 117 B.R. 375 (Bkrtcy. N.D. Ill. 1990); *In re Myrvold*, 44 B.R. 202 (Bkrtcy. D. Minn. 1984), *aff'd*, 784 F.2d 862 (8th Cir. 1986). This is true because, pursuant to 11 U.S.C. § 1141, all property previously owned by the Debtor in Possession becomes property of the Reorganized Debtor when the plan is confirmed.

A conversion to Chapter 7, after the entry of the order of confirmation, creates an estate consisting of all property owned by the Debtor at the "commencement of the case". 11 U.S.C. § 541. The provisions of 11 U.S.C. § 348, which describe the effects of conversion, specifically state that conversion does not "effect a change in the date of . . . the commencement of the case . . ." 11 U.S.C. § 348(a). Therefore, the converted Chapter 7 estate consists of property that was owned by the Debtor when it initially filed its Chapter 11 proceeding to the extent the same existed on the date of conversion.

In the case at bar, all property that previously was owned on the date of filing of the Chapter 11 was validly owned by the Reorganized Debtor by virtue of the order of confirmation and 11 U.S.C. § 1141 on the date of conversion. Included in that property owned by the Reorganized Debtor was the proceeds from the sale of the assets including the "enhanced value of the sales proceeds . . . generated by the Reorganized Debtor subsequent to confirmation of its Plan" which was found by the Bankruptcy Court to be "a post confirmation asset." App. C at 23a. Since the order of confirmation was not revoked, the newly appointed Chapter 7 trustee will not be entitled to receive the proceeds from a post confirmation sale of assets by the Reorganized Debtor.

The District Court's assumption to the contrary and the Eleventh Circuit's acceptance of the same is inconsistent with the language of 11 U.S.C. §§ 1141, 348 and 541. The right of a Chapter

7 trustee to property received by a Reorganized Debtor in a confirmed Chapter 11 proceeding after conversion to a Chapter 7 is an important and often recurring issue in the bankruptcy courts. Guidance from the United States Supreme Court on the Trustee's rights to that post-confirmation property is important to the proper administration of the bankruptcy laws.

CONCLUSION

The petition for a writ of certiorari should be granted in order to allow this Honorable Court to address these important bankruptcy, commercial, and business issues.

Respectfully submitted,

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APPENDIX A — PER CURIAM OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT FILED JANUARY 20, 1994

[DO NOT PUBLISH]

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 92-7033

D.C. Docket Nos. CA92-0567-P-M
90-10232

IN RE: MOBILE FREEZERS, INC.,

Debtor.

MOBILE FREEZERS, INC.,

Plaintiff-Appellant,

versus

UNITED STATES OF AMERICA,

Defendant-Appellee.

Appeal from the United States District Court
for the Southern District of Alabama

(January 20, 1994)

Before ANDERSON and DUBINA, Circuit Judges, and GODBOLD, Senior Circuit Judge.

PER CURIAM:

The district court determined that the bankruptcy court abused its discretion in failing to conclude that there was "cause" to convert this case from Chapter 11 to Chapter 7 under 11 U.S.C. § 1112(b). The district court based its decision, *inter alia*, on several material defaults by the Debtor and on general equitable considerations. After a careful review of the record, we agree with the district court that there were one or more material defaults by the Debtor, and that the record contains overwhelming evidence of equitable considerations pointing to the result reached by the district court.

Accordingly, the judgment of the district court is

AFFIRMED.

APPENDIX B — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ALABAMA, SOUTHERN DIVISION FILED OCTOBER 21, 1992

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

CIVIL ACTION 92-0567-P-M

In Re:

MOBILE FREEZERS, INC.,

Debtor.

ORDER ON APPEAL REVERSING
AND REMANDING THE ORDER OF BANKRUPTCY COURT
GRANTING DEBTOR'S MOTION TO SELL ALL ITS ASSETS
AND DENYING UNITED STATES' MOTION TO CONVERT

This case is before the court on the appeal of the United States of America from the Bankruptcy Court's order granting the debtor's motion to sell all its assets and denying the United States of America's motion to convert the case from Chapter 11 to Chapter 7. The United States brings this appeal on behalf of the Defense Logistics Agency, an unsecured creditor.[1] This order is reviewable by the court under an abuse of discretion standard. For the reasons set forth below, this court finds that the order was an abuse of discretion.

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1. The terms "secured creditor" and "unsecured creditor" are used, for the convenience of the reader, to refer to the holder of a secured claim and the holder of an unsecured claim, respectively. The Bankruptcy Code distinguishes between secured and unsecured claims, not between secured and unsecured creditors. H.R. (Reform Act of 1978 § 501), *reprinted in* Norton Bankr. L. & Prac. 307, 308 (1990).

Appendix B

For an investment of $6,000 in "new capital," the debtor's three equity security holders were to maintain their equity holdings and management positions under the Chapter 11 plan approved, over the dissent of the unsecured creditors, as "fair and equitable" by the Bankruptcy Court. There is nothing in the record of the $6,000 being paid. Under the plan, the debtor was to continue to operate as a going concern. Instead of continuing operations, debtor sold all of its assets to Christian Salvesen, which was also a secured creditor of the debtor. This sale was authorized by the Bankruptcy Court's order granting the debtor's motion to sell all its assets. The funds from this sale have been placed in escrow, and the Bankruptcy Court's order disbursing funds has been stayed by this court.

The debt owed to Christian Salvesen was unimpaired under the plan. The other secured creditor, the Small Business Administration (SBA), was impaired. The SBA's claim of $125,000, secured by a lien on property worth $35,000, would result in repayment of only 20 percent of the unsecured amount, for an impairment of $67,500. The other unsecured creditors also are to receive 20 percent of the face value of their claims under this plan.

Under the old absolute priority rule, which is still in effect for Chapter 7 liquidations, this plan could never have been approved. Under the absolute priority rule, a plan was fair and equitable — and thus able to be confirmed — only if it conformed to that rule. Victor Brudney & Marvin Chirelstein, *Corporate Finance: Cases and Materials* 188 (3d ed. 1987). The absolute priority rule, enunciated by Justice Douglas in *Consolidated Rock Products Co. v. Du Bois,* 312 U.S. 510, 85 L. Ed. 982, 61 S. Ct. 675 (1941), provided that each successive class of senior creditors must be paid in full before any junior class was paid at all. While the payment

need not have been in cash, the senior creditors must have given securities worth at least as much as the face value of their claims. *Id. See* Brudney & Chirelstein, *supra* at 197. This plan would have clearly failed under the old absolute priority rule because equity holders are paid while both secured and unsecured creditors are impaired. However, a conversion to Chapter 7, which still has the absolute priority rule, would not have diminished the rights of secured creditors, but would have substantially improved payments to the unsecured creditors.

Whatever the merits of the plan in this case, it at least had a logical justification. The theoretical basis of a chapter 11 bankruptcy is that the debtor is worth more to the current equity holders than to potential bidders in the market for the debtor's assets. *See* H.R. (Reform Act of 1978 Chapter 11), *reprinted in* Norton Bankr. L. & Prac. 728 (1990). As a result, a Chapter 11 plan envisions that the continued operation of the debtor will result in a stream of earnings, which is defined as inflows less outflows, whose present value is greater than the liquidation value of the firm.

The substantive protection of the old absolute priority rule has been replaced by procedural protection. Part of this scheme of protection is district court review of the Bankruptcy Court's order on the motion to convert.

Commentators have recognized that reorganizations tempt existing management to abuse the Bankruptcy Code and transfer wealth from creditors to equity holders. Bradley & Rosenzweig, *The Untenable Case for Chapter 11,* 101 Yale L.J. 1043, 1045-46 (1992) (citing sources). Here, the equity holders prosper at the expense of the partially secured creditor, the Small Business Administration, and the unsecured creditors. A Chapter 7

liquidation would avoid this transfer of wealth, and thus this court must examine the facts of the case as well as the applicable law to see if the failure to convert to Chapter 7 constituted an abuse of discretion.

I. *The Bankruptcy Court Abused Its Discretion in Failing to Convert the Case*

After a review of the relevant standards for a conversion, it is apparent that the Bankruptcy Court abused its discretion in failing to grant the motion to convert this case from a Chapter 11 to a Chapter 7 bankruptcy. Bankruptcy Court orders stemming from such motions are reviewable under an abuse of discretion standard. *See In re Sullivan Central Plaza I, Ltd.*, 935 F.2d 723, 728 (5th Cir. 1991). However, the Bankruptcy Court does not have unfettered discretion regarding conversion. Rather, the Bankruptcy Code provides specific factors for the court to consider in determining whether to convert the case. *See* 11 U.S.C. § 1112. The factors which are to considered in deciding the motion to convert favor conversion.

A Bankruptcy Court may convert a chapter 11 reorganization plan to a chapter 7 liquidation if, among other things, it finds that the debtor did not substantially consummate the plan or if the debtor materially defaulted with respect to the plan. *See* 11 U.S.C. § 1112(b)(7)-(8). This list of reasons to convert a case is not exhaustive. H.R. Rep. (Reform Act of 1978), *reprinted in* Norton Bankr. L. & Prac. 815 (1990). *See In re Albany Partners, Ltd.*, 749 F.2d 670, 674 (11th Cir. 1984) (affirming Bankruptcy Court's dismissal of debtor's Chapter 11 petition "for cause," because equitable nature of determination allows court to consider good faith of debtor, despite good faith's absence from list of factors to be considered in determining "cause"). The reasons given in the

statute favor a conversion of this case from a reorganization to a liquidation.

A. *The plan was not substantially consummated*

The Bankruptcy Court's conclusions of law regarding the substantial consummation and material breach of the confirmed plan are reviewable *de novo* on appeal. *In re Morris*, 950 F.2d 1531, 1533 (11th Cir. 1992) (affirming, on *de novo* review, Bankruptcy Court's retention of subject matter jurisdiction over adversary proceeding, despite termination of Chapter 11 case, where retention was consistent with majority view under case law). After a review of the record, it is clear that this plan was not substantially consummated and was materially breached, contrary to the Bankruptcy Court's conclusions.

In the instant case, the three part test for substantial consummation has not been satisfied.

> "substantial consummation" means —
> (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
> (B) assumption by the debtor . . . of all or substantially all of the property dealt with by the plan;
> *and*
> (C) commencement of distribution under the plan.

11 U.S.C. § 1101(2) (emphasis added). The Bankruptcy Court equated the debtor's ability to effect consummation with consummation itself (Bankruptcy Court's order at 6). This contradicts the clear language of the statute, which looks to the

degree of completion of the plan in order to determine whether conversion is proper.

The appellant from the Bankruptcy Court's grant of the motion to disburse funds and the motion for sale of substantially all assets has moved for a stay of the Bankruptcy Court's order, thus this case is distinguishable from the Eleventh Circuit and district court cases dismissing appeals from Bankruptcy Court orders as moot where no stay was sought and a sale of assets took place. *E.g. Miami Center Limited Partnership v. Bank of New York,* 838 F.2d 1547 (11th Cir.), *cert. denied* 488 U.S. 823 (1988). In *Miami Center,* the Eleventh Circuit noted that:

> [i]t is settled law in this circuit that when a *debtor* fails to obtain a stay pending appeal of the bankruptcy court's or the district court's order setting aside an automatic stay and allowing a creditor to foreclose on property, the subsequent foreclosure and sale of the property rendered moot any appeal.

Id. at 1553 (emphasis added). As in the foreclosure sale of property, the sale of debtor's assets approved by the Bankruptcy Court's order transfers an asset or assets from the debtor to a third party. Here the Bankruptcy Court approved the sale of all the debtor's assets, on the debtor's motion, but placed the proceeds from the sale in escrow. The creditor appealing from the Bankruptcy Court's order moved for a stay from this court, and the stay was granted. As a result, the concern that cases such as *Miami Center* display for considerations of finality, protection of the integrity of the foreclosure sale process, and the court's inability to rescind the sale and grant relief, *id.* at 1553, are inapplicable to the instant case. Because the funds from the sale were placed in escrow, the concern

that a substantially consummated plan would be set aside does not arise. If the case is converted to a Chapter 7 liquidation, only the distribution of the funds held in escrow would be effected.

The first and third part of the test for substantial consummation have not been met by the debtor in the instant case. The debtor has made no distributions under the plan. This demonstrates no desire by the debtor to meet the obligations from the operation of the plan. The payment set out in the plan was accomplished, not by operation of the plan or desire to pay its creditors from the operation of the company, but was accomplished only by the sale of the assets and the debtor reaping a windfall. All the debtor's assets were sold, including their licenses to do business. Because the funds from the sale of assets were placed in escrow, and because this court granted a stay of the Bankruptcy Court's order, the transfer of property and distribution of assets under the plan have not taken place.

Furthermore, this debtor cannot substantially consummate the plan. Since all of the assets of the debtor have been sold, the second part of the test, which calls for assumption by the debtor of property dealt with by the plan, clearly has not been met and cannot be met.

The motion to convert should have been granted because the confirmed plan can never be consummated. The inability of the debtor to consummate a plan under Chapter 11 should lead to a dismissal of the case, or a conversion of the case to a Chapter 7 liquidation. *See* 5 Collier on Bankruptcy para. 1112.03(d) (vii) (1992) (where "there is no longer any likelihood of consummating a plan, if the court so determines, it is duty bound to end the case"). *See also Lehman v. Commissioner,* 129 F.2d 288, 290 (2d Cir. 1942) (petitioner cannot take tax write-off for stock of

corporations involved in bankruptcy reorganization proceedings where such proceedings had not been dismissed by the bankruptcy court, because it is the duty of such a court to dismiss a proceeding where there is no longer any likelihood of a reorganization plan being consummated, thus petitioner is engaging in mere conjecture that she will be entirely uncompensated). The plan in this case called for the debtor to continue operations and retain title to all assets. Neither of those aspects of the plan can be fulfilled by the debtor, thus the plan is not — and cannot be — substantially consummated.

B. *There was a material default by the debtor*

This court disagrees with the Bankruptcy Court's conclusion of law regarding the debtor's material default under the plan. The Bankruptcy Court held that, while there had "technically" been a default under the plan by the debtor, this default was excused because the debtor proposed to make the payments specified by the plan (Bankruptcy Court's order at 6-7).

However, the asset sale clearly contradicts the terms of the plan and is therefore a material breach. The disclosure statement used for confirmation of the plan states that the plan provides that the debtor will continue to operate, and will retain title to all assets. By selling all its assets, the debtor clearly was not continuing its operations and retaining title to all assets. As a result, the debtor materially breached the plan.

In addition, the equity holders have not made their payments to the debtor as called for by the plan. Since these equity holders stand to gain over $180,000 from the sale of the debtor's assets, the failure to pay the entire $6,000 due is especially puzzling. The debtor's president never made the $2,000 payment which he was

supposed to make under the plan, and it seems that the other two equity holders also failed to pay the $4,000 due from them. Ordinarily, equity holders are not allowed to receive anything under a reorganization plan if dissenting creditors are impaired. *See* 11 U.S.C. § 1129(b)(2)(B). However, the Bankruptcy Court could confirm this plan only because the equity holders were willing to make the $6,000 payment to the debtor. Thus, the failure to make this payment is a material default.

If the debtor seeks to reap the benefit of a $187,064 windfall while paying its unsecured creditors only 20% of their claims, the proposal to sell the assets paid the unsecured creditors only 20% of their claims while giving the debtor an enormous windfall clearly violates the Bankruptcy Code and is grossly inequitable to those unsecured creditors.

II. *The Bankruptcy Court Order Allowed the Debtor to Achieve by Motion What it Could not by Amending the Plan*

At the time the debtor made a motion to sell all of its assets, the United States, representing an unsecured creditor, objected to the motion and made a motion to convert to Chapter 7. By granting the debtor's motion to sell all its assets, and by denying the United States' motion to convert, the Bankruptcy Court allowed the debtor to achieve by motion what it could not do by amending the plan. Because the motion to disburse, coupled with the motion for the sale of the debtor's assets, allows the debtor to achieve a result outside the confines of Chapter 11, which is designed to permit a business to continue operating, this would be an additional factor favoring the grant of the motion to convert.

When the motion to sell all of the debtor's assets was granted by the Bankruptcy Court, the debtor achieved the same result as a

Chapter 7 case. Under Chapter 7, the debtor is liquidated, and does not continue operations or retain title to its assets. This result is what the motion to sell all of the debtor's assets accomplishes, despite the fact that motion was filed by a debtor in a Chapter 11 case.

The difference between filing a motion to sell all assets in this Chapter 11 case and a Chapter 7 liquidation is that, in the Chapter 11 situation, the proceeds of the liquidation go to the debtor, while, in a Chapter 7 case, the creditors would be able to claim the proceeds first. Thus the plan in this case, together with the order granting the debtor the ability to sell all its assets, allows a liquidation while circumventing the order of priority for the payment of claims established by Chapter 7. It would be unconscionable to commit this windfall to the debtor's benefit at the expense of the creditors. This is an abuse of bankruptcy purposes.

If this had been a Chapter 7 case, the equity holders of the debtor would have gotten nothing from the liquidation. The priority of claims in a Chapter 7 liquidation is governed by 11 U.S.C. § 726. The order of priority for payment, under that Section, is as follows: first, administrative expenses and taxes, then post-petition claims, then unsecured claims for wages and employee benefit plans, then tax claims, then the claims of unsecured creditors, and lastly to the debtor. *Id. See* 11 U.S.C. § 507. In this case, the debtor, i.e. its equity security holders, would have gotten nothing under a Chapter 7 liquidation.

The plan and the orders do not adversely effect holders of secured claims. The treatment of claims of creditors holding a security interest is governed by 11 U.S.C. § 506. Section 506 provides that a claim is secured to the extent of the creditor's

interest in the debtor's property. 11 U.S.C. § 506(a). Secured claims are entitled to "adequate protection." 11 U.S.C. §§ 361-64. Here, all secured claims retain their security interests, thus they are adequately protected.

Even the confirmation of the plan took place on a faulty basis. It is true that the appeal from the confirmation was dismissed, by agreement. However, the valuation of the debtor for the purpose of confirming the plan and the value received, post-confirmation, for the debtor's assets differ greatly. The disclosure documents used to obtain confirmation reflect a liquidation value of $441,409 for the debtor's assets. When the debtor actually sold its assets, post-confirmation, it received $775,000. This is a discrepancy of $331,591, a sizeable figure. Indeed, if the $775,000 figure was used as the liquidation value of the debtor in confirmation proceedings, the unsecured creditors would have received $383,000 in liquidation. This is too large a discrepancy, or difference, to ignore. Under a more realistic evaluation, the plan could not have been confirmed, over the creditor's dissents, as fair and equitable by the Bankruptcy Court. This makes the difference in valuation extremely significant in this case.

Where the difference in value is of this magnitude, and where the debtor certainly has more information on the value of the assets than the creditors, and where a windfall of this magnitude works to the benefit of the debtor and against the creditors, and results in such a large windfall to the debtor, the United State's motion to convert to Chapter 7 should have been granted. It is fundamentally wrong to fund a new venture for the debtor with the sale of assets partly accumulated at the expense of its creditors.

The debtor could not have achieved by amending the plan what it achieved by motion. In this case, there were creditors who

dissented from the plan which was proposed. Every class of creditor must either: one, approve a plan; two, receive more under the plan than they would have received in a liquidation; or three, be "crammed down" by having the court find that a plan is fair and equitable, in order for a plan to be confirmed. 11 U.S.C. § 1129(a)(7)(A). Here, the dissenters do not receive more under the plan, as effected by the motion to sell all assets, than they would have received under a Chapter 7 liquidation. Furthermore, the plan, as effected by the motion, cannot be fair and equitable under the Code.

This plan could not have been approved as fair and equitable by the Bankruptcy Court if the debtor had attempted to amend the plan to sell all its assets. The Code provides that dissenting creditors must either, one, be paid more under a Chapter 11 plan than in a Chapter 7 liquidation or, two, that no creditor junior to that class will receive or retain any property under the plan in order for the plan to be approved as fair and equitable. 11 U.S.C. § 1129(b)(2)(C). This plan, as effected by the motion to sell all assets, cannot meet the fair and equitable test. As discussed above, the dissenting unsecured creditors would have received more had the debtor been liquidated. In addition, a class junior to the unsecured creditor, the equity security holders, receives property under the plan. Therefore, it is clear that the purpose of the debtor in making its motion to sell all assets was to achieve by motion what it could not by amendment.

This court notes that a recent Supreme Court case suggests that the conversion provision of Chapter 11 may be an important vehicle for ensuring compliance with confirmed Chapter 11 plans. In *Toibb v. Radloff*, __ U.S. __, 115 L. Ed. 2d 145, 111 S. Ct. 2197 (1991), the Court held that an individual debtor not engaged in a business was eligible for relief under Chapter 11. Justice

Appendix B

Blackmun, writing for a majority of the Court, noted that the conversion provisions are an important tool. The court was persuaded that concerns regarding involuntary consumer debtors who would be forced into Chapter 11 by their creditors were overstated.

> We find these concerns overstated in light of the code's provisions for dealing with recalcitrant Chapter 11 debtors. If an involuntary Chapter 11 debtor fails to cooperate, this likely will provide the requisite 'cause' for the bankruptcy court to convert the Chapter 11 case to one under Chapter 7.

Toibb, 115 L. Ed. 2d at 154. A Chapter 11 debtor who attempts to circumvent the priority provisions of Chapter 7 by selling all of its assets after a Chapter 11 plan is confirmed is no less of a recalcitrant debtor than a consumer debtor who refused to cooperate in a plan of reorganization. Thus it is appropriate to apply the conversion provisions to such a debtor.

The debtor's argument that the $187,064 windfall to the equity holders is a function of their retention of the control premium, and thus a natural result of the confirmation of the reorganization plan, is erroneous. The equity holders in the instant case received their windfall as the result of the ability to discharge debts in bankruptcy and then sell off all the debtor's assets, thus profiting at the expense of the creditors, and not because they retained the control premium.

It is true that equity holders who retain their holdings after a bankruptcy stand to prosper. Because the burden of debt on the debtor is diminished by the discharge of some or all of that debt in

bankruptcy, the outflows from the debtor are decreased. This means that the stream of future earnings of the debtor is increased, because the stream of earnings is the difference between the inflows to the debtor and the outflows from the debtor. In turn, this increases the present value of that stream of future earnings. Because the equity holders are the residual takers of this stream of earnings, the value of their equity holdings would increase, however, the value of their holdings would also increase if the equity holders, who have the ability to select management, and here are themselves the management, increased the value of the debtor by making wise business decisions. *See Sullivan Central Plaza I,* 935 F.2d at 728 (sale of debtor's principal asset supports finding that debtor could not successfully reorganize); *Miami Center,* 838 F.2d at 1555 (court will consider whether post-confirmation relief could adversely affect re-emergence of debtor as a viable entity); Jost, *Chapter 11 Under Fire,* 78-Jul A.B.A. J. 32 (instead of rescuing firms, Chapter 11 merely prolongs their agony); Warren, *Bankruptcy is a Better Alternative,* Nat'l L.J., April 20, 1992 at 15 (8 out of 10 companies never emerge from Chapter 11 despite the breathing space it provides for management). *See also* Bradley & Rosenzweig, *supra* at 1075 (Bankruptcy Code has not materially increased survival rate of bankrupt firms, while helping incumbent management retain control).

Here, however, the equity holders of the debtor prospered because they were able to do by motion what they could not do by amending the plan of reorganization, and not because they managed the post-bankruptcy debtor well. In fact, the debtor had not managed the post-confirmation operation of the business well. No payments had been made from the operation of the business under the plan. Thus the debtor's argument is unpersuasive.

Appendix B

Because of the potential for equity holders to prosper at the expense of creditors if they are allowed to retain their holdings, the procedural protection discussed above places limits on what a Chapter 11 plan may contain. This plan, as effected by the post-confirmation motions, went beyond the allowable boundaries of such a plan. In addition, by selling all its assets, the debtor thwarted the essential purpose of the Chapter 11 plan, which was to allow the debtor to continue its operations. As a result, and because of other factors favoring conversion, the Bankruptcy Court should have granted the motion to convert. Failure to grant the motion constituted an abuse of discretion, thus this court REVERSES the Bankruptcy Court's order. The Bankruptcy Court is hereby ORDERED to convert the case to Chapter 7 and pay the funds held in escrow as provided by Chapter 7 and consistent with this order.

DONE this 20th day of October, 1992.

s/ illegible
SENIOR UNITED STATES DISTRICT JUDGE

APPENDIX C — PROPOSED FINDING OF FACT, CONCLUSIONS OF LAW, AND ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF ALABAMA, SOUTHERN DIVISION DATED JULY 2, 1992

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

CASE NO. 90-00232

IN RE:

MOBILE FREEZERS, INC.,

Debtor.

PROPOSED FINDINGS OF FACT,
CONCLUSIONS OF LAW, AND ORDER

This matter comes before the Court on the resetting of the Debtor's Motion to Use Escrow Funds to Make Cash Payments Required under Debtor's Amended Plan of Reorganization, as Amended, Confirmed by Order Which Became Final on January 5, 1992 and to Pay Balance to Debtor for Operations (hereafter "Motion to Disburse"), the objections thereto filed by AmSouth Bank and the United States Defense Logistics Agency, and the Motion to Convert filed by the United States Defense Logistics Agency, due notice on the hearing on said Motions having been given; Irvin Grodsky having appeared for the Debtor, R. Steve Terry having appeared for AmSouth Bank, William R. Sawyer, Assistant United States Attorney, having appeared for the United States Defense Logistics Agency, John Green having appeared for Trust Company Bank, and Travis M. Bedsole, Bankruptcy

Appendix C

Administrator, having appeared pro se; testimony from D.J. Ficarino having been presented and the Examiner's Report having been presented, reviewed and considered; the Court FINDS, CONCLUDES and ORDERS as follows:

FINDINGS OF FACT

1. Mobile Freezers, Inc. filed (hereafter sometimes referred to as "Debtor" or "Reorganized Debtor" its Petition for Relief under Chapter 11 of Title 11 of the United States Code on February 5, 1990. After the filing of Debtor's petition, Debtor continued to engage in the business of processing and packaging seafood by using its owned and rented equipment at its subleased facility in Mobile, Alabama.

2. Thereafter, Mobile Freezers, Inc. proposed and filed a First Amended Plan of Reorganization, which after being amended, was confirmed by Order of this Court on July 12, 1991 (hereafter the "Plan").

3. The Order of Confirmation was appealed by the United States Defense Logistics Agency to the United States District Court for the Southern District of Alabama. The Debtor and the United States Defense Logistics Agency reached a settlement agreement regarding the appeal and the appeal was dismissed on December 5, 1991.

4. The Plan provides for payment of 100% of all administrative and priority claims, 100% of the allowed secured claim of the Small Business Administration, 50% of the allowed claim of Laitram Machinery, Inc. for unpaid prepetition equipment lease payments for a lease assumed by the Debtor, and 20% of all remaining unsecured claims with payments to be made to priority,

secured, and unsecured creditors over a period of years. The Debtor's Plan provides for the Reorganized Debtor's continuation of its business activities and the funding of the above payments out of future earnings from operations. The Plan has an effective date described as the 30th day after which the Order of Confirmation is no longer appealable which, under the circumstances of this case, was January 5, 1992.

5. Subsequent to the Effective Date of the Plan, the Reorganized Debtor petitioned the Court to sell substantially all of its assets, i.e., all items of equipment located at its processing plant, and to assign its sublease on its processing plant to Christian Salvesen, its sublessor and secured creditor for the amount of $775,000.00 plus certain additional considerations. On March 10, 1992, this Court approved the sale and directed the Reorganized Debtor to retain the proceeds of the sale in an escrow account until further order of this Court.

6. The Reorganized Debtor consummated the sale on March 23, 1992 and filed this Motion to Disburse immediately thereafter. The Reorganized Debtor's Motion to Disburse requests an order accelerating the date of distribution of Plan payments to creditors so that all creditors are paid their respective Plan distributions upon entry of the order approving the accelerated distribution date, authorizing a disbursement from the sale proceeds escrow account of the amount necessary to fund that payment, and further authorizing payment of the balance of the sale proceeds escrow account to the Reorganized Debtor. At the hearing of the Motion to Disburse, the Reorganized Debtor consented to retaining a portion of the sale proceeds in escrow for payment of anticipated 1992 federal and state income taxes which the Reorganized Debtor projected will be substantially increased as a result of the sale.

7. On April 28, 1992, this Court entered an order authorizing

a disbursement from the sale proceeds escrow account of an amount sufficient to pay all allowed administrative and priority claims and certain post confirmation operating expenses. Further, this Court, with the consent of the Debtor, appointed an examiner, Warner Gale, to determine the projected income tax inability resulting from the sale, to prepare a projected income and expense statement, and to prepare a projected cash requirements statement of the Reorganized Debtor for a one-year period of time.

8. As of the date of this hearing, the Debtor had disbursed and, thus, paid in full all allowed administrative and priority claims presented to the Court as of said date. The balance in the sale proceeds escrow account is $488,262.61. In addition to this sum, the Debtor will receive within thirty (30) days $47,000.00 from a jointly held escrow retainage account with Christian Salvesen. The total funds available to the Debtor, therefore, will be $535,262.61. The balances owed to creditors by class under the terms of the Plan are as follows:

a. Administrative: estimated balance of attorney's fees	$15,000.00
b. Secured	$34,000.00
c. Unsecured - Laitram Machinery	$21,230.00
d. General Unsecured	$227,968.61

The amount of state and federal income tax liability for 1992 is projected to be between $25,196.00 and $119,516.00 depending upon the amounts of net income earned by the Reorganized Debtor during the remainder of the year. The Debtor, without objection from the creditors, has agreed to retain $65,000.00 in escrow for the payment of 1992 federal and state income taxes.

9. The Disclosure Statement Accompanying the Plan which

was circulated to all creditors in connection with the vote solicitation for confirmation of the Plan reflected an estimated liquidation value (as opposed to market or book value) of the Debtor's equipment of $300,000.00. No creditor has alleged that the Debtor misstated that value. No evidence has been presented that the liquidation value of the equipment was misstated in the Disclosure Statement. The information concerning the value of the equipment sent to the creditors in the Disclosure Statement and about which a representative of the Debtor testified at the Plan confirmation hearing was not false.

10. The desire by the sublessor to terminate Debtor's operation at the subleased location was a major factor in the Debtor's obtaining the enhanced purchase price of $775,000.00 for the equipment and the sublease.

11. The Reorganized Debtor negotiated and finalized the sale of equipment and the sublease to Christian Salvesen subsequent to confirmation of the Plan of Reorganization. The Reorganized Debtor disclosed all material facts relevant to its future operations and the value of its equipment in conjunction with the confirmation of its Plan.

12. The Reorganized Debtor plans to continue in business by providing seafood unloading services and by buying shrimp at shipside and selling it at wholesale.

13. The Reorganized Debtor's proposal to pay to the creditors their respective distribution under the Plan immediately, as opposed to making payments over a period of time, is beneficial to the creditors. The accelerated payments will provide the creditors an enhanced monetary value for their claims and any risk that the reorganized Debtor may fail to make the planned payments is eliminated.

14. The enhanced value of the sales proceeds from the sale of the equipment and the assignment of the sublease is a post confirmation asset generated by the Reorganized Debtor subsequent to confirmation of its Plan.

15. A reasonable fee for Warner Gale is $600.00 for his services as examiner.

CONCLUSIONS OF LAW

1. Section 1112(b) of the Bankruptcy Code permissively allows the Bankruptcy Court to convert a Chapter 11 case to a Chapter 7 case for cause. The United States has raised two of the specific examples of "cause" described in Section 1112(b) to support its motion, namely, the Debtor's liability to effectuate substantial consummation of a confirmed plan and a *material* default by the Debtor with respect to a confirmed plan (emphasis added). The Reorganized Debtor's proposal, contained in the motion, to pay all creditors their respective distributions immediately coupled with the Debtor's proof that it has the funds to comply with its proposal, establish that the Debtor is able to effectuate substantial consummation of its confirmed plan. While the Debtor technically did default under the Plan by failing to make certain payments in January and February, 1992. Debtor's proposal made in March, 1992 to immediately pay not only those late installments, but also all future installments, establishes that those missed installments were not "material" under the Plan under the circumstances of this case. Debtor's proposal to immediately pay the amount of distribution owed to creditors under the confirmed plan is an enhancement of the creditors' rights and is not an event of default under the Plan. The Government has failed to present sufficient reason by this Court to dismiss or convert this case to a Chapter 7 case under Section 1112(b) of the Bankruptcy Code.

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2. The issue presented is who is to receive the unexpected additional monies derived from the sale of the Debtor's assets subsequent to the Effective Date of a confirmed Plan of Reorganization. The Order confirming Debtor's Plan of Reorganization is a final order which has a *res judicata* effect on all issues between the Debtor and its prepetition creditors. *In re St. Louis Freight Lines* 45 B.R. 546 (Bkrty. E.D. Mich. 1984). The confirmed Plan has the effect of replacing the preconfirmation debts owed to the creditors with new indebtednesses described in the confirmed Plan and each of those new indebtednesses is a new and binding contract between the debtor and its creditors. *In re Herron* 60 B.R. 82 (Bkrty W.D. La. 1986); *In re Ernest* 45 B.R. 700, 702 (Bkrty D. Minn. 1985); *In re Garsal Realty, Inc.* 39 B.R. 991, 994 (N.D. N.Y. 1984); *aff'd* 755 F. 2d 913 (2d Cir. 1985). Unless the confirmed Plan is modified or revoked, the Debtor's obligation, post-confirmation, *viz a viz* its prepetition creditors, is to comply with the terms of its Plan. Likewise, the prepetition creditors' rights against the Debtor are limited to enforcing compliance with its obligation under the Plan. The occurrence of a post-confirmation windfall, just as an unanticipated post-confirmation extraordinary profitable year, does not alter the nature of that obligation.

3. A motion to modify a confirmed Plan must be filed prior to substantial consummation of the confirmed Plan by the Debtor or the Plan proponent. The objecting parties did not propose the confirmed Plan and do not have standing to seek its modification. 11 U.S.C. Section 1144(b), *In re Horne,* 99 B.R. 132 (Bankr. M.D. Ga., 1989).

4. The confirmed Plan may not be revoked under the facts of this case because the creditors have not alleged nor proven that the order of confirmation was procured by fraud. 11 U.S.C. Section 1144, *In re Hartz* 38 B.R. 215 (Bkrty. S.D. N.Y. 1984).

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5. The proposal by the Debtor to accelerate payments of the Plan distribution to the creditors immediately is in the best interests of creditors and the Reorganized Debtor.

ORDER

It is therefore ORDERED, ADJUDGED, and DECREED that the Motion to Dismiss or Convert filed by the United State Defense Logistics Agency be, and the same is hereby DENIED; and it is further

ORDERED, ADJUDGED, and DECREED that the objections to the Motion filed by United States Defense Logistic Agency and AmSouth Bank be, and the same hereby is, OVERRULED; and it is further

ORDERED, ADJUDGED, and DECREED that the Debtor's Motion to Disburse, as orally amended, be and the same is, hereby GRANTED; and it is further

ORDERED, ADJUGED, and DECREED that the Reorganized Debtor be and is hereby AUTHORIZED to disburse to the remaining prepetition creditors of the estate from the sales proceeds escrow account the full amount of their respective distributions under the confirmed Plan; and it is further

ORDERED, ADJUDGED, and DECREED that the sum of $283,198.61 be disbursed from the sales proceeds escrow account to Mobile Freezers for the payment by Mobile Freezers of said distributions; and it is further

ORDERED, ADJUDGED, and DECREED that Warner Gale be and is hereby awarded a fee for his services as Examiner in the amount of $600.00; and it is further

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ORDERED, ADJUGED, and DECREED that the sum of $600.00 be disbursed from the sales proceeds escrow account to Warner Gale, for his services as Examiner in this case; and it is further

ORDERED, ADJUDGED, and DECREED that the Reorganized Debtor retain the sum of $65,000.00 in the sales proceeds account until 1993 to be used for payment of its 1992 federal and state income taxes; and it is further

ORDERED, ADJUDGED, and DECREED that the sum of $187,064.00 be immediately disbursed to Mobile Freezers, Inc. from the sales proceeds escrow account for its use in its business operations; and it is further

ORDERED, ADJUDGED, and DECREED that this Order shall constitute a final Order in this matter and shall be immediately appealable; and it is further

ORDERED, ADJUDGED, and DECREED that the Debtor shall be stayed from making the disbursements described herein so as to allow any interested party to appeal this Order for a period which shall terminate on the expiration of ten (10) days from the date of this Order or on the date that any appellate court having jurisdiction shall rule on a motion to stay pending appeal, whichever occurs first.

DATED this 2nd day of July, 1992

s/ Arthur B. Briskman
ARTHUR B. BRISKMAN
United States Bankruptcy Judge